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63149—36

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 895

ALGERNON S. SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 896

EDWARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 897

LEONARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 36–40) is reported in 32 B. T. A. 289. The opinion of the Court of Appeals (R. 84–90) is unreported.

JURISDICTION

The judgments of the Court of Appeals were entered March 2, 1936. (R. 90–92.) The petition for writs of certiorari was filed April 6, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, with respect to the purchases and sales of certain stocks, the brokerage firm of Schafer Bros. was a dealer in securities and entitled to make its return for the taxable year 1929 under the inventory method of accounting.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> * * * * *
>
> (c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as

conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 105. *Inventories by dealers in securities.*—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—
>
> (a) At cost;
>
> (b) At cost or market, whichever is lower; or
>
> (c) At market value,
>
> may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of re-

sale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 34–36) may be summarized as follows:

During the taxable year 1929, and for several years prior thereto, the petitioners, under the firm name of Schafer Bros., conducted a general brokerage business with offices at 120 Broadway, New York. Leonard Schafer owned a seat on the New York Stock Exchange and was the floor member. Algernon and Edward were the office members of the firm. All three were actively engaged in the business. (R. 34.)

This partnership was a dealer and merchant in securities on commission and on margin, and in such capacity executed orders for purchase or sale of securities by its customers either on the Exchange, the Curb, or wherever the particular securities were listed. From 1925 through 1929, the partnership participated in a great number of syndicate and underwriting operations. Also, as a part of its business activities, but with no relation to its customers' accounts nor to the execution of orders for its customers, the partnership has

always, to some extent, bought and sold securities for its own account. (R. 34–35.)

Beginning in 1925 or 1926 and continuing through 1929 the partnership traded in securities for its own account much more extensively than had been its practice during 1925. Such trading was conducted through orders executed by Leonard Schafer or other brokers and had no relation or connection with the accounts of the partnership's customers, but were purchased in expectation of a rise in the market price and for the purpose of reselling, to any buyer, at a profit for the partnership's own account. Such securities were not purchased for investment. (R. 35.)

Sales of the securities were made through orders given Leonard Schafer or other brokers, and the identity of the purchasers was not known. Such purchases and sales were entered in the so-called "Error Account", which was an old account carried on the books of the partnership and used for its own transactions in securities. The name "Error Account" had no significance. (R. 35.)

During 1929, the partnership purchased 107,500 shares and sold 92,500 shares of 72 different issues of securities, entered in the "Error Account". The number of such securities carried at the close of 1929 was unusually large due to the drop in the market and the inability to sell at a profit but all except a comparatively few were sold during 1930 (R. 35).

In 1923, the New York Stock Exchange made a rule requiring its members to inventory securities for the purpose of certain Exchange questionnaires. Prior to 1925, the partnership had carried its own securities (as distinguished from those carried for customers' accounts) in the "Error Account" at cost, but beginning with that year and including 1929, it inventoried them at their fair market value both at the beginning and end of the year. Such change was made as a matter of business policy, but with the knowledge of the effect of the taxing statutes. (R. 35.)

The Commissioner determined that this partnership was not a dealer in securities with respect to those carried in the "Error Account" and that they must be carried at cost. Accordingly, he disallowed the use of inventories and increased the partnership's income by $511,667, the difference between the cost over the market value at the beginning and the end of the year 1929. (R. 36.)

The Board concluded, as to this branch of the partnership's business, that it was a speculator and not a dealer in securities within the meaning of the regulations, and approved the deficiencies found by the Commissioner. (R. 40–42.) The Court of Appeals sustained the Board's decisions. (R. 90–92.)

ARGUMENT

Pursuant to the broad grant of authority contained in Section 22 (c) of the Revenue Act of 1928, *supra,* p. 2, the Commissioner of Internal

Revenue has set out, in Article 105 of Regulations 74, *supra*, p. 3, the requirements which must be met before a person can, as a dealer in securities, use the inventory method of computing his income. These regulations have been approved as reasonable and as fairly carrying out the intent of the statute. *Seeley* v. *Helvering*, 77 F. (2d) 323 (C. C. A. 2d); *Wilson* v. *Commissioner*, 76 F. (2d) 476 (C. C. A. 10th). Moreover, their terms are plain. To be a dealer in securities entitled to use inventories, one must (1) be a merchant of securities, (2) have an established place of business, (3) be regularly engaged in purchasing securities for resale to customers at a profit, and (4) buy as a merchant for resale and not for investment or speculation. It is apparent that in determining whether a taxpayer meets these requirements, the primary question is one of fact. The courts have so treated it, and have held that if different conclusions may be reasonably drawn from the same undisputed facts, the findings of the Board are binding on the reviewing court. *Wilson* v. *Commissioner, supra.*

In the instant cases, the court below found that the findings of the Board were supported by substantial evidence, and upheld the conclusion that the petitioners were speculators, and not entitled to the use of inventories. The court pointed out that there was no evidence to show that the firm held itself out as having on hand securities for

sale on their own account to customers, or that they offered securities for sale in the sense that a merchant offers his stock in trade for sale (R. 87). By this statement the court gave a construction to the regulations which is in accord with the decisions in the circuit courts of appeal. *Commissioner* v. *Stevens,* 78 F. (2d) 713 (C. C. A. 2d); *Seeley* v. *Helvering, supra; Harriman National Bank* v. *Commissioner,* 43 F. (2d) 950 (C. C. A. 2d); *Hammitt* v. *Commissioner,* 79 F. (2d) 494 (C. C. A. 3d); *Commissioner* v. *Charavay,* 79 F. (2d) 406 (C. C. A. 3d); *Berks County Trust Co.* v. *Commissioner,* 78 F. (2d) 810 (C. C. A. 3d); *Wilson* v. *Commissioner, supra.*

Petitioners contend, however, as the first basis for granting writs of certiorari that the present case is in conflict with decisions in the Second and Third Circuit Courts of Appeals. *Commissioner* v. *Stevens,* 78 F. (2d) 713 (C. C. A. 2d); followed in *Fried* v. *Commissioner,* decided April 6, 1936, C. C. H., Vol. 4, 1936, par. 9222 (C. C. A. 2d); *Commissioner* v. *Charavay,* 79 F. (2d) 406 (C. C. A. 3d). They rely largely upon the statement by the lower court that, in its opinion, the cases were indistinguishable from the present one, and its refusal to reach the same result (R. 86). We submit while the lower court's judgment is correct, its opinion is in error in this regard, and that the facts in the *Stevens* and *Charavay* cases are quite different from those presented in the instant case.

The *Stevens* and *Charavay* cases were part of the same proceeding involving the brokerage firm of Stevens and Legg, and were considered by the Board of Tax Appeals *sub nom. Estate of Harry E. R. Hall,* 29 B. T. A. 1255. The Board's opinion in that case reveals that the firm of Stevens and Legg was a "specialist" on the New York Stock Exchange in some fourteen securities. As such, it held itself out as a dealer in those securities. At all times it carried a sufficient stock of them on hand to supply the demands of its customers, who numbered 101, and who made 268 separate purchases of its stocks during the taxable period. Its floor member occupied a regular post on the floor of the exchange, where he always stood ready to buy or sell. The firm's sales were large, and to meet the demands it kept on hand a large supply of the stocks which it constantly replenished through purchases.

This brief summary reveals the wide difference between the facts of that case and those of the present one. The purchases made by the Shafer firm were not to replenish a stock in trade, but were rather, as the Board found (R. 35), independent of the customers of the firm, and were made in expectation of a rise in the market price and for resale to anyone at a profit to the firms' account. The firm did not sell to and buy from brokers *as a merchant,* as did Stevens and Legg; it purchased and sold as a speculator. Moreover, in cases in-

volving facts quite similar to the present ones, both the Second and Third Circuit Courts of Appeal have recently denied the inventory privilege to speculators, with opinions which reveal their agreement with the principles laid down by the opinion in the instant case. *Seeley* v. *Helvering*, 77 F. (2d) 323 (C. C. A. 2d); *Hammitt* v. *Commissioner*, 79 F. (2d) 494 (C. C. A. 3d).

Petitioners allege, as a second ground for certiorari, that the question here presented is of great importance. However, there are only six cases involving this question now pending in the courts, five in the Circuit Courts of Appeals and one in a district court.[1] These appeals are pending in courts which have already passed on this question. An examination of the decisions in these cases and other Board decisions indicates that the Board has followed the regulations in requiring a showing that the taxpayer is regularly engaged as a merchant of securities in order to obtain the privilege of reporting on an inventory basis. See *Adirondack Securities Corp.* v. *Commissioner*, 23 B. T. A.

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[1] The cases on appeal are *Vaughan* v. *Commissioner*, 31 B. T. A. 548; *Brendle* v. *Commissioner*, 31 B. T. A. 1188; *Securities Allied Corp.* v. *Commissioner*, memorandum opinion rendered September 5, 1934; *Twining* v. *Commissioner*, 32 B. T. A. 600, all on appeal to the Circuit Court of Appeals for the Second Circuit; and *O'Neil* v. *Commissioner*, memorandum opinion rendered June 29, 1935, on appeal to the Court of Appeals for the District of Columbia. The other case is *The Leach Corp.* v. *Blacklidge*, pending in the United States District Court for Northern Illinois.

61; *Northeastern Surety Co.* v. *Commissioner*, 29 B. T. A. 297; *Oil Shares, Inc.*, v. *Commissioner*, 29 B. T. A. 664; *Hamill* v. *Commissioner*, 30 B. T. A. 955; *Lowell* v. *Commissioner*, 30 B. T. A. 1297. There seems to be no conflict as to the rule to be applied and the cases have depended largely on their individual facts.

CONCLUSION

We submit that the decisions on the question involved are not in conflict and that the instant cases do not present a question which warrants review by this Court. The petition should be denied.

Respectfully submitted.

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